

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B04

PLR-147033-12

Date:

April 09, 2013

### Legend

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Amount 1 = \$

Amount 2 = \$

Amount 3 = \$

Amount 4 = \$

Amount 5 = \$

b =

c =

d =

e =

f =

Dear :

This is in reply to your request for a private letter ruling that the outstanding amount of a loan to the extent the proceeds were used to acquire and integrate an adjacent apartment into the cooperative apartment you own is qualified principal residence indebtedness under § 108(h) of the Internal Revenue Code.

### FACTS

In Year 1, you purchased an apartment unit in a cooperative apartment complex. In Year 2, you incurred indebtedness of Amount 1 and used \$b of the proceeds to

purchase the adjacent apartment and \$c of the proceeds for structural renovations and improvements to combine the two units into one apartment unit (Loan1). The renovations were complete after several months. The original apartment was about d square feet and the adjacent unit was about e square feet. After the renovation, you can move freely through the combined apartments as one residence, and only one door is used to enter the hallway of the common area. You represent that you have owned and used the cooperative apartment unit (both before and after you combined it with the adjacent apartment unit) as your only residence and that it is your principal residence, as that term is used in § 121. You represent that Loan1 was secured by the stock in the cooperative apartment unit.

In Year 3, the amount of Loan1 was Amount 2. In Year 3, you refinanced Loan1 to Amount 3 with Loan2. You did not use the amount of Loan2 exceeding Amount 2 to purchase, construct or substantially improve any principal residence. In Year 4, you represent that due to a tremendous drop in property value, you approached the lender of Loan2 about settling that loan for a one-time payment that was less than its principal amount. The lender agreed to the settlement and forgave what you represent is Amount 4 of Loan2.

#### LAW AND ANALYSIS

Section 61 provides that, except as otherwise provided in subtitle A, gross income means all income from whatever source derived, including income from discharge of indebtedness. See § 61(a)(12).

Section 108(a)(1)(E) provides that gross income does not include any amount that (but for § 108(a)) would be includible in gross income by reason of the discharge (in whole or in part) of a taxpayer's indebtedness if the indebtedness is qualified principal residence indebtedness that is discharged before January 1, 2014.

Section 108(h)(2) provides that, for purposes of § 108, the term "qualified principal residence indebtedness" means acquisition indebtedness within the meaning of § 163(h)(3)(B).

Section 108(h)(5) provides that, for purposes of § 108(h), the term "principal residence" has the same meaning as when used in § 121.

Section 108(h)(4) provides that if any loan is discharged, in whole or in part, and only a portion of the loan is qualified principal residence indebtedness, § 108(a)(1)(E) applies only to so much of the amount discharged as exceeds the amount of the loan (as determined immediately before such discharge) that is not qualified principal residence indebtedness.

Section 108(h)(3) provides that § 108(a)(1)(E) does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

Section 163(h)(3)(B)(i) defines “acquisition indebtedness” as any indebtedness that is (I) incurred in acquiring, constructing or substantially improving any qualified residence of the taxpayer, and (II) is secured by such residence. The term also includes any indebtedness resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

The indebtedness incurred in Year 2, the proceeds of which were used to purchase the adjacent apartment unit and to make structural renovations and improvements to combine the two units into one unit, qualifies as indebtedness incurred in substantially improving a qualified residence of the taxpayer. These costs are analogous to costs incurred to build an addition onto a freestanding residence. The additional living space of your residence was increased by f% as a result of the improvements. Such an improvement constitutes a substantial improvement for purposes of § 163(h)(3)(B).

Your residence is an apartment in a cooperative housing corporation. Section 1.163-10T(q)(1) of the Income Tax Regulations provides generally that a residence includes stock in a cooperative housing corporation owned by a tenant-stockholder if the house or apartment which the tenant-stockholder is entitled to occupy by virtue of ownership of such stock is a residence within the meaning of § 1.163-10T(p)(3)(ii). In addition, § 163(h)(4)(B) provides that “Any indebtedness secured by stock held by the taxpayer as a tenant-stockholder (as defined in § 216) in a cooperative housing corporation (as so defined) shall be treated as secured by the house or apartment which the taxpayer is entitled to occupy as such a tenant-stockholder.”

You represent that both Loan1 and Loan2 were secured by the stock in the cooperative apartment. Thus, Loan1 satisfies the requirements of § 163(h)(3)(B) to be acquisition indebtedness. In addition, Loan2 qualifies as acquisition indebtedness under the flush language of § 163(h)(3)(B)(i), but only to the extent of Amount 2. In Year 4, when Loan 2 was forgiven, you represent that its balance was Amount 5. At that time, the amount that was acquisition indebtedness was Amount 2.

Because Amount 2 of the indebtedness is acquisition indebtedness under § 163(h)(3)(B)(i), it is qualified principal residence indebtedness under § 108(h)(2).

## CONCLUSION

Based strictly on the information submitted, representations made, and the law and analysis set forth above, we conclude that the principal amount of Loan1 that was outstanding immediately before it was refinanced with Loan2 constitutes acquisition indebtedness under § 163(h)(3)(B), and thus is qualified principal residence indebtedness under § 108(h)(2).

Except as expressly provided in the preceding paragraph, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. For example, we do not express any opinions concerning whether § 108(h)(3) applies to the forgiveness of Loan2, whether your cooperative apartment is your principal residence under §§ 108(h) and 121, or whether the principal amount of Loan1 was Amount 2 at the time it was refinanced with Loan2.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

You must attach a copy of this letter to any income tax return to which it is relevant. If you file your returns electronically, you may satisfy this requirement by attaching a statement to the return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Michael J. Montemurro  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Income Tax & Accounting)